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Arizona Corporation Commission
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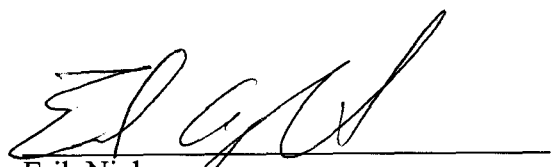
IN THE MATTER OF THE APPLICATION OF UTILITY SOURCE, LLC, AN ARIZONA CORPORATION, FOR A DETERMINATION OF THE FAIR VALUE OF ITS UTILITY PLANTS AND PROPERTY AND FOR INCREASES IN ITS CHARGES FOR UTILITY SERVICE BASED THEREON.

DOCKET NO. WS-04235A-13-0331

NIELSEN CLOSING BRIEF

Erik A. Nielsen (Intervenor) hereby files a brief in the matter of Utility Source LLC (hearafter US or the Company) application for a rate increase that produces a revenue requirement of 100.56% increase for the water division and an increase of 166.39% for the wastewater division (Company Final Schedules) with a rate structure that produces impacts on the average residential consumer of an increase of 85.96 % for water and 239.4% wastewater. ACC Staff's final schedules recommend revenue increases of 77.48% for the water and 155.54% for the wastewater division (ACC final schedules) while RUCO's recommend revenue requirement produces increases of 29.87% for water and 82.22% for wastewater (RUCO final schedules). The proposed adjustments included in my final schedules and justified here are based on the facts established in this case would reduce these increases to something much more reasonable for consumers. My adjustments are based on the facts that establish just and reasonable allowed operational expenses, just and reasonable rate base, and adjusted CAIC based on new information. In addition this filing addresses the alternatives proposed to address the ongoing operation of the standpipe and its effects on rates.

RESPECTFULLY SUBMITTED this 23rd day of March, 2015.



Erik Nielsen
4680 N. Alpine Drive
P.O. Box 16020
Bellemont, Arizona 85015

Original and thirteen (13) copies of the foregoing filed this 23rd day of March, 2015, with:

Docket Control
Arizona Corporation Commission
1200 West Washington Street
Phoenix, Arizona 85007

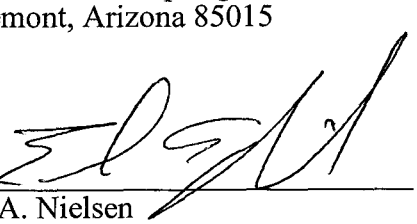
Copy of the foregoing mailed this 23rd day of March, 2015, to:

Steve Wene, Esq.
MOYES SELLERS & HENDRICKS, LTD.
1850 North Central Avenue, Suite 1100
Phoenix, Arizona 85004
swene@law-msh.com
Attorneys for Utility Source, LLC

Wes Van Cleve
Matthew Laudone
Legal Division
Arizona Corporation Commission
120 West Washington
Phoenix, AZ 85007

Daniel Pozefsky
Residential Utility Consumer Office
1110 West Washington St., Suite 220
Phoenix, Arizona 85007

Terry Fallon
4561 Bellemont Springs Drive
Bellemont, Arizona 85015

By: 
Erik A. Nielsen

INTRODUCTION

The revenue requirement proposed by the Company and the subsequent rates impact on on consumers should be considered to be unjust and unreasonable. This current rate case represents the first rate case since the initial rate case (WS-04235A-06-0303) whereby the ACC accepted plant as part of rate base conditioned on the anticipation of 350 new customers as proposed by the company. The facts show that the Company had water and waste water capacity to service these anticipated customers yet the company, ACC and RUCO are only adjusting These customers did not materialize. The company proposes removing elements of rate base that were adjudicated in WS-04235A-06-0303, such as shallow wells and DW #4 but the company does not proposed to make adjustments to the wastewater division for excess capacity it clearly maintains. The ability of the ACC to determine the value of the rate base and expenses has been undermined due to obfuscation on the part of Utility Source as demonstrated in this current case. The courts clearly acknowledge the constitutional authority of the ACC and the obligations of public service companies to assist in helping the ACC conduct it business. In State v. Tucson Gas, Electric Light & Power Co., 1914, 15 Ariz. 294, 138 P. 781, 784, the court said:

"In order that the Corporation Commission might act intelligently, justly, and fairly between the public service corporations doing business in the state and the general public, section 14 was written into the Constitution. The `fair value of the property' of public service corporations is the recognized basis upon which rates and charges for services rendered should be made, and it is made the duty of the Commission to ascertain such value, not for legislative use, but for its own use, in arriving at just and reasonable rates and charges, and to that end the public service corporations are required to furnish the Commission all the assistance in their power." Cited in 80 Ariz. 145 (1956) 294 P.2d 378 SIMMS, v. ROUND VALLEY LIGHT & POWER COMPANY

This current rate case cannot be separated from the historical trajectory of this utility and the lack of full disclosure on the part of the Company to ACC staff and lack of full

compliance with ACC regulations and orders (see Nielsen direct and rebuttal testimony). Furthermore the trajectory of this case demonstrates that the Company has not been completely forthcoming with relevant facts requested under data requests and a motion to compel. The role of forward looking rate making must take into account the known facts at the time of the case and apply them to establishing rates. New facts have surfaced in this case that directly challenge the original cost basis of the company rate base and have direct implications for the water and wastewater rate base, subsequent revenue requirements and the reasonableness of the rates for customers.

Overall the foundation for the Company proposed rates is unsupported and represents operational expenses that provide services beyond Utility Source customers, an inflated rate based and unsupportable cost of capital that result in rates which are "excessive, unreasonable and unjust." Therefore these proposed rates violate the AZ constitution where a utility is entitled only to rates which are "just and reasonable." Ariz. Const. art. 15, § 3.

The remainder of this brief will address the facts and interpretations associated with acceptable operational costs, rate base elements, CAIC, the standpipe and the rate structure.

OPERATIONAL COSTS

Ms. Perry comingled time with other companies controlled by company principles

The facts of this case clearly demonstrate that Ms. Perry and the office are not solely dedicated to the provision of Utility Source business. Exhibits 3 and 4 of Nielsen's surrebuttal testimony, hearing exhibits Nielsen 5-10, Nielsen surrebuttal testimony p.10 and Mr. McCleve's hearing testimony p74 all corroborate these facts. The company and Staff are not recommending any adjustment to her compensation even though she is listed as the secretary of

the Pecans Homeowners association, an agent for another company and her phone number is listed in multiple real estate listings as the contact for the Pecans POA. Mr. McCleve testified at the hearing that, "The vast majority of her time is spent with Utility Source" (p.74) and he affirmed that her only salary is from utility source. On page 78 Mr. McCleve admitted that Ms. Parry does "some work" for the Pecans POA that also lists the Utility Source address as its address. Nielsen exhibit 5 also shows Mrs. Perry acting as a notary public for Mr. McCleve's land transactions.

The uncontested facts, taken together, provide reasonable support to make an adjustment for her compensation for duties performed in providing the Company service in recognition of the other

Illegitimate and co-mingled phone expenses

Nielsen surrebuttal testimony, Exhibits 3 and 4 of Nielsen's surrebuttal testimony, hearing exhibits Nielsen 5-10, Nielsen Motion to compel phone records and hearing testimony of Mr. McCleve clearly establish that phone expenses are excessive and unreasonable. Given the comingling of company activities and eliminating phone expenses for Mr. McCleve's wife and daughter I propose reasonable phone expenses of 100% of Water manager ($900), 50% Mrs. Perry bookkeeper ($450), 100 % of NTS 1-800 line ($228.22) and 20% of McCleve and Buelcheck phone lines ($360) and disallow phone expenses for Mr. McCleve's wife and daughter. These expenses should be Split between water and sewer divisions. In hearing testimony Mr. McCleve admitted to having his wife and daughter cell phones included as expenses and he claimed that it was "basically compensation that I get out of the Company are those phone bills". He also said he had no way of knowing what percentage of his cell phone is

dedicated to US but that it was a percentage. I believe my percentage adjustments are reasonable given the many businesses controlled by Mr. McCleve.

Co-mingled Copier and Staples expenses

Following the same factual establishment that these offices are used for many businesses the costs of copier and staples expenses should also be shared proportionally between the 7 entities involved and is reasonable to provide sufficient resources for billing, invoicing and other expenses and activities

Mrs. Perry Auto expenses

Mr. McCleve testified under cross-examination that Ms. Perry's Auto allowance is part of her compensation and that she probably travels up to Bellemont a few time a year (p.79 line 19) however he could not produce any verification of trips she had made to Bellemont related to company business. Therefore I proposed allowed costs of 2 round trips for errands per week to bank/post per week (40 miles) calculated at Federal rates split between water and sewer divisions. It is entirely unreasonable for customers over 150 miles away to pay for auto expenses totally unrelated to the operation of the utility.

SRP electricity bills in lieu of rent

The Company and ACC staff position to reallocate these payments as rent for office space should be based on facts and not trying to justify these high expenses to match the illegitimate bills that were supplied. ACC staff formula for necessary square footage greatly overestimates the office space needed given the actual employees and individuals involved with the company.

One could consider Mr. McCleve and Mrs. Perry as the two people who work in the office with some very minor temporary assistance from time to time. Mr. Buelcheck the other owner does not live in the vicinity and should not be considered for these calculations. The principal of proportionality should then be applied to the 7 or more companies sharing that space and the realtors that use the space for sales. Given that this expense was not recorded as rent or lease but as miscellaneous expenses it should not be included as part of the revenue requirement. If the ACC determines that this bartering arrangement was a valid test year expense then at the minimum it should apply the proportionality test to the office space in question.

According to Tomain and Cudahy (2004) Energy Law in a nutshell, "The determination of value has generally been left to the management of the utility under the theory that these are essentially business decisions which will not be second guessed by a regulatory agency or a court. **Managerial good faith is presumed**. Although both agencies and courts have the legal authority to supervise the utility's management, they will not substitute their judgment unless there is an abuse of managerial discretion." **[Emphasis added].** I believe that the "arrangement" between Mr. McCleve and his partner for this payment of a personal power bill as well as the other expenses documented below suggest that this presumption of managerial good faith no longer exists in this case. It is important to note that many of these details related to office and phone expenses would not have been provided to the parties had I not insisted for this information in my data requests or conducted independent investigation.

In a similar case cited in Simms v. Round Valley Light and Power (1956) the courts have also ruled that shared operations of businesses and personnel should be allocated proportionately given that some of the expense is not used to provide service to the customers.

"There was evidence that the company is operating a mercantile business independent of its activities as a public utility. In operating this mercantile business, it used land, building, and fixtures, the total value of which was included in arriving at the plant value. Considering that some adjustment should be made by allocating some value to the portion of the property not used in rendering public service but used in connection with the mercantile business, the staff recommended a deduction of $2,621 from the rate base. The commission in its order stated that the company in its recommended base made no deduction for this item but held that some deduction should be made. How much the commission deducted for this latter item the commission did not say. Some subtraction was properly made for the portion of the property being used for purposes other than service to the public as a utility."

RATE BASE ADJUSTMENTS

A foundational element of Nielsen's proposed adjustments to the rate base in his filed schedules is that the company is entitled to a reasonable average return upon capital *actually expended or invested* in plant used and useful in the provision of a public service and not just in property held or unsubstantiated values claimed for that property.

In Arizona Simms v Round Valley Light and Power Co. (1956) the court determined that the commission is "required to find the fair value of [the utility's] property and use such finding as a rate base for the purpose of calculating what are just and reasonable rates." It would be impossible for the ACC to make these findings if it were impeded by a lack of disclosure by the utility or did not take into consideration new information in a particular rate case that is central to the determination of fair value. In the present case the Company is asking that the ACC reconsider determinations of value from their first rate case WS-04235A-06-0303, and it is only fair that any new information relevant to the determination of fair value is considered particularly in light of the apparent historical and current lack of transparency from

the Company to the ACC staff even though they have this obligation under Arizona Administrative Code R14-2-411D to give "complete and authentic information as to its properties and operations". All facts provided by the parties regarding previously determined values and having a bearing on the proper determination of values should be considered by the ACC.

Used and Usefulness of Wastewater Treatment Facility

The facts of the case establish that the 37,500 gallon activated treatment facility is not used and useful as a wastewater treatment facility and therefore $333,500 should be removed from the wastewater division. This excess wastewater capacity should be considered like Deep Well #4. The wastewater plant was included in the previous rate case because it was intended to serve the additional customers in the Flagstaff Meadows Unit III, Phase I but it is now removed from rate base because it is not used and useful as an activated sewage plant.

Prior to the hearing, ACC staff engineer Mr. Thompson had declared the 37,500 gallon plant as used and useful because it was being used to store sludge. Under cross examination from Mr. Nielsen in the hearing, Mr. Thompson affirmed that the 100,000/gal/day treatment plant should be able to operate without the 37,500 gallon activated treatment plant as a sludge storage unit and it is not being used as an activated sewage treatment plant (p. 794 and 795). To assume this plant meets the used and useful test would be to assert the reasonableness of using a $2,000 laptop as a door stop. It is useful but it is not used for what it was designed for to provide a service to customers.

Furthermore Mr. McCleve under cross examination from Mr. Nielsen confirmed that he had signed as owner of the wastewater treatment plant an ADEQ Sewage Treatment Facility

Capacity Assurance form in 2007 that affirmed the constructed capacity able to take on additional customers from Flagstaff Meadows Unit III phase 1 (p. 50). Mr. McCleve also testified in the hearing that the 37,500 gallon sewage treatment plant had been functioning but that the company had taken that plant off line when they installed the 100,000 gallon activated sewage treatment plant (p 769)

It is important to note that the company, RUCO or the ACC staff did not remove this plant from service in their final schedules even though it has been disconnected from the system as a sewage treatment plant for many years. The Company clearly has excess capacity in the Wastewater division and this 37,500 gallon plant should be removed from the plant in service. The failure to remove this plant is a major reason that the wastewater division is requesting a much higher revenue requirement than the water division yet it should be justified on exactly the same grounds as the removal of Deep Well #4 in the determination of the plant fair value.

Adjustments to rate base land values for water and wastewater divisions

Nielsen's final schedules suggested an adjustment to disallow of $143,105 of the water division and an adjustment to disallow $74,523 for the wastewater division for the original cost value of land dedicated to providing water and wastewater services. Nielsen made several data requests and filed a motion to compel regarding supporting information to substantiate these values that appeared unreasonable. The reason I wanted to understand the per acre values for the water division is that with the company removing two shallow wells the value of those lands should also be removed and needed to be established.

During my hearing testimony, I presented exhibits 14 and 15 that clearly demonstrated the original cost values based on official county records of land sales to Mr. McCleve upon which the water and wastewater facilities are currently located. Based on the total acreage actually used and useful for the provision of water and wastewater services and the original cost values listed in county property records, I arrived at reasonable adjustments to actually reflect the original costs of these lands used in the provision of service. Under cross examination Mr. McCleve could not recall if these values were established by a professional assessment or some other measure. The value of these lands have not changed through the course of ACC proceedings over the years and remain exactly as they were presented in the original application (WS-04235A-04-0073, Schedule 6). It appears that the Company is unable to substantiate its valuations for these lands in violation of the Arizona Administrative Code R-14-2-411. In the absence of actual proof of acceptable valuation for these properties, the original cost method proposed in my hearing testimony and exhibit 15 should guide the adjustments. I

As cited in SIMMS, v. ROUND VALLEY LIGHT & POWER COMPANY 80 Ariz. 145 (1956) 294 P.2d 378 a fair guide for rate base that we can apply to this question of land would follow: "One of the most difficult tasks for a rate-making body is to properly value utility properties to establish a base that when related to the fixed rate of return will be just and reasonable to both the company and the consuming public. The methods used to reach this result have been productive of much litigation and debate. In the absence of an admitted change in material and labor costs since construction, the original costs less depreciation of the physical plant plus working capital and other items of value necessary to render the service is recognized as a fair guide." McCardle v. Indianapolis **Water** Co., 1926, 272 U.S. 400, 47 S.Ct.

144, 71 L.Ed. 316; Los Angeles Gas & Electric Corp. v. Railroad Commission, 1933, 289 U.S. 287, 53 S.Ct. 637, 77 L.Ed. 1180

Disallowance of Deep Well #1 and #3 Dropped in final schedule

While the Company does not currently own the land, and thus the wells, for deep well #1 and #3 since those lands are registered to Fuelco LLC, I believed that these should be removed from the rate base. While I believe the letter of the law would say these lands need to represent an actual investment by the public service utility and if they are not legally owned the company cannot earn a return on these wells. Given the used and usefulness of the wells I now believe that these can be included as part of the rate base

Adjustments to CIAC

Fire hydrants—Nielsen direct testimony p15 and Nielsen Surrebuttal testimony p.3 and exhibit 1 clearly establish that hydrants are the responsibility of the developer and absent any more detailed information from the company $37,500 should be added to CIAC.

Water and Wastewater Distribution System: Clear evidence from Nielsen direct testimony (Exhibit 2) that Empire companies installed the wastewater and water distribution lines for Flagstaff Meadows Unit II and the Townhomes at Flagstaff Meadows. These facts have not been contested by the Company. Mr. McCleve was asked in the hearing and he affirmed that Empire had built these distribution lines. Multiple data requests to reconcile CIAC were not responded to so we have no idea what constitutes the CIAC listed in the rate application. It is

reasonable to conclude that adjustments should be made reflecting the value of these distributions lines to CIAC of $73,252 for the water and $109,206 to the wastewater division.

Undeclared Hook-up Fees as CIAC: Nielsen direct testimony p10-13 and accompanying exhibit 2 clearly demonstrate the intent and implementation of hookup fees prior to regulation by the ACC. RUCOs exhibit 2 clearly establishes a denied and undisclosed current practice on the part of the Company to charge hookup fees.

Mr McCleve in the hearing testimony responded to my question "were any hook up fees charged to consumers or the builders" he replied—"originally there were. When the subdivision was first started before the Corporation Commission became involved there were hook up fees. Yes." (p. 253). And then in response to my question about if those were declared in any previous rate case Mr. McCleve replied, "You'd have to ask Mr. Bourassa about that. I assume so. Certainty everything was disclosed to the Commission when the original order was completed" (p254). A review of the original CC&N application WS-04235A-04-0073, Schedule 6 includes $215,000 as contributions in the form of hook-up fees for the water division and $387000 as contributions in the form of hook-up fees for the wastewater division. These fees were not included in the 2006 initial rate case application WS-04235A-06-03036 schedules B-2 for water and sewer. That these values mysteriously disappear in the Utility Source applications before the ACC and Mr. McCleve's affirmation of their collection makes their absence from the schedules particularly disturbing and undermines one of the foundations of ratemaking—the company cannot earn a return on plant that does not represent its investment. My schedule recommendations would include hookup fees for 201 customers

when the company was ordered to halt hook-ups during its initial CC&N case at $1,000 for each water connection and $1,800 for each sewer connection.

The case law appears clear on this issue of prior contributions. In Princess Anne Utilities Corp. v. Commonwealth 211 Va. 620, 623, 179 S.E.2d 714, 716 (1971) as cited in Cogent v ACC 1984 the court concluded that the idea excluding contributions in aid of construction from rate base "is based on principles of fairness. It is inequitable to require utility customers to pay a return on property for which they, and not the utility have paid." The court continued saying, "To force the customers and users of a utility to pay rates predicated upon the value of a facility which they themselves substantially paid for ... is the antithesis of a just and reasonable rate. Conversely, where the customers and users of a utility have substantially paid for the facilities employed in the public service, the antithesis of a just and reasonable rate is one that would permit a utility's stockholders to recover a return on money which they, in fact, never invested. State ex rel. Valley Sewage Co. v. Public Service Commission, 515 S.W.2d 845, 851 (Mo. App. 1974). E.g., DuPage Utility Co. v. Illinois Commerce Commission, 47 Ill.2d at 553-54, 267 N.E.2d at 664-65; City of Hagerstown v. Public Service Commission, 217 Md. 101, 141 A.2d 699 (1958); Mississippi Public Service Commission v. Hinds County Water Co., 195 So.2d 71, 76 (Miss. 1967); Windham Estates Ass'n v. State, 117 N.H. 419, 422, 374 A.2d 645, 647 (1977) (contributions in aid of construction "must be deducted from the rate base as these are funds upon which the investors are not entitled to any return.").

In two cases with similar facts and circumstances the courts have found that contributions from customers or related companies should be counted as contributions or else it would have the

effect of making customers pay twice. In State ex rel. Valley Sewage Co. v. Public Service Commission, 515 S.W.2d 845, 851 (Mo. App. 1974) the court asserted the following:

"The fourth ground for relief asserted by the Company is, to say the least, innovative. The thrust of the Company's fourth ground appears to be that no contributions in aid of construction were ever made to the Company because it and Freeman Construction, by virtue of common ownership and officers, were "one and the same". The Company then conveniently assumes, without aid or force of logic, and absent factual or legal support, that what the Commission treated as contributions in aid of construction to the Company actually consisted of property acquired from capital expenditures made by Freeman Construction; thus, no contributions, in fact, were ever made to the Company. The Company's assumption is as false as it is convenient, and can be fairly characterized as a technical argument at best. As heretofore noted, the Company's original plant, in the final analysis, was built from funds that emanated from its customers and users, and not, in reality from funds of Freeman Construction. The Company cites Blackwell Printing Company v. Blackwell-Wielandy Company, 440 S.W.2d 433 (Mo.1969) and Fletcher Cyclopedia Corporations, Permanent Edition, Volume 1, Sec. 43, for the proposition that although common ownership of the stock of two corporations and identity of officers is not sufficient to make one corporation the alter ego of the other, the converse is true if the controlling corporation has "no separate mind, will or existence of its own" and is merely the business "conduit" for the controlling corporation. If for no other reason, the Company's cited authorities are unpersuasive and inapplicable because the original plant, in the final analysis, was built from funds emanating from its customers and users. Moreover, although expressly avoiding any definitive ruling, this court seriously doubts that a publicly regulated utility corporation can be merely the alter ego or business conduit of a business corporation."

Furthermore in Princess Anne Utilities Corp. v. Commonwealth, 211 Va. 620, 623, 179 S.E.2d 714, 716 (1971) the court found that the Company's assertion that contributions from land developers or brother-sister companies should be considered as contributions since the utility customers ultimately bore the cost of such contributions. The customer letters submitted in this docket and the evidence submitted in my testimonies (e.g. State property reports, direct testimony exhibit 1.B) established that the hook-up fees were paid by customers and thus they should be considered as CIAC and to do otherwise would be unjust. I had requested documentation from the company on these prior contributions but they insisted those documents had been turned over the POA. The POA has no such records.

POSITION ON STANDPIPE

I am strongly supportive of ACC staff alternative for what I consider the illegally established standpipe operation outside the existing CC&N. Treating the standpipe as a separate system protects consumers although I am concerned it promoted excessive water extraction and distribution with weak to non-existent incentives to conserve water for haulers. I would recommend exploring other rate structures that would discriminate between small haulers and large haulers with differential pricing as well as collecting more information from the company about when they actually use Well #4 in support of the standpipe and how much water they are pumping from well #4 in support of the standpipe.

RATE DESIGN

The rate design as proposed by the company disproportionately allocates the revenue requirement to residential customers. For example for the wastewater division commercial users currently make up 21% of use but under the Company's proposed rate design the commercial customers will only pay 11% of the revenue requirement. This structure should be adjusted to protect residential customers from bearing a disproportionate share of the proposed rate increase.

CONCLUSION

As early as 1906, the AZ supreme court held that the "effect of the rate upon persons to whom [utility] services are rendered is as deep a concern in the fixing thereof as is the effect upon the stockholders or bondholders." *Salt River Valley Canal Co. v. Nelssen,* 10 Ariz. 9, 13, 85 P. 117, 119 (1906). I trust that in consideration of these final schedules and the facts of this case that the ACC will protect consumer interests from an unreasonable, unjust and unfair rate increase.